Is double-digit inflation on the horizon in Hungary?

By now we shouldn't be surprised by Hungary's higher-than-expected inflation reading. The 8.3% year-on-year February reading is the highest figure since August 2007

The acceleration in headline inflation was mainly on food prices

8.3%

Headline inflation (YoY)

ING forecast 7.9% / Previous 7.9%

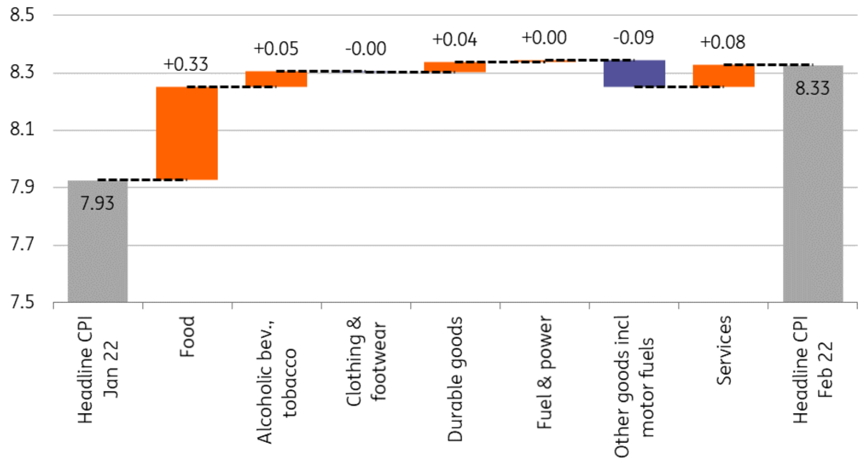
Higher than expected

Inflation is up, again

Some of us had hoped that the government's anti-inflationary measures, like the fuel and basic food price cap, and the utility cost freeze, would somehow be able to stop the acceleration in the headline inflation reading. We were wrong, as the strong repricing has continued all over the consumer basket. Headline inflation accelerated by 0.4ppt last month, causing an upside surprise yet again. The 8.3% year-on-year February reading is the highest figure since August 2007.

There is not much to cheer about, however month-on-month inflation did decelerate from 1.4% to 1.1% in February. Cold comfort.

Main drivers of the change in headline CPI (%)

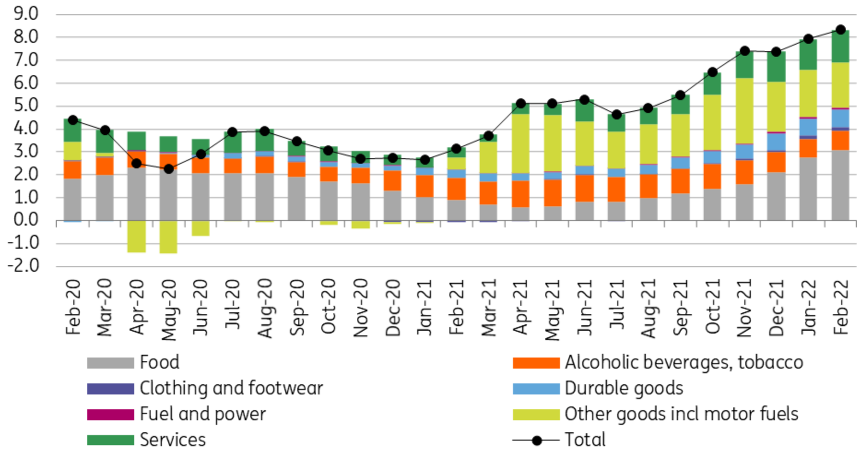


Source: HCSO, ING

The details

- The acceleration in headline inflation was mainly on food prices, as this product group showed an 11.3% yearly based price change, up from barely 10% from the previous month. And this is despite the fact that the government reverted some basic food prices to the October level and has capped those prices from February until May. Roughly two-thirds of the price pressure in food products is related to processed food. This is a result of the strong spill-over from the more than 31% yearly increase in agricultural producer prices. And probably the price cap introduced by the government lead retailers to raise the prices of other products to cover some of their losses on the capped items.
- Inflation in services also accelerated by 0.3ppt to 5.5% year-on-year in February. Most services were showing a significant uptick in prices. Leisure activities, transportation and rents were among the big movers. The February 0.7% monthly price increase in services – matching the January figure – is way above the historical average, showing a strong repricing on all sorts of cost side pressures (e.g. transportation, energy, and labour costs). These pressures will strengthen further based on the commodity market implications of the war in Ukraine.
- The forint was behaving reasonably well during the first three months of February, yet inflation in durables accelerated to 8.3% year-on-year. As inflation has been rising steadily abroad as manufactured goods producers have been facing cost pressures in a shortage economy, this hardly comes as a surprise. Here, the late-February to early-March forint weakening (roughly 10%) will add to the inflation pressure in the coming months, complemented by the energy price shock.

The composition of headline inflation (ppt)

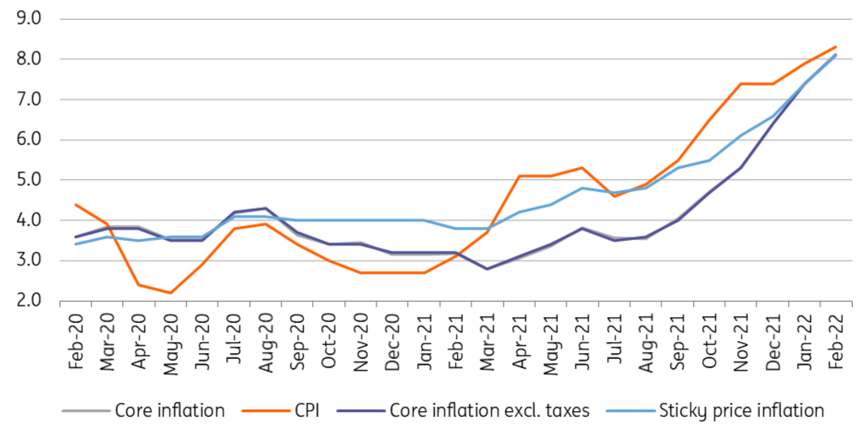


Source: HCSO, ING

Underlying inflation moves higher

The year-on-year price increase was above 5% in 69% of the consumer basket. This is what we call widespread inflation pressure, as both core and non-core elements added to the accelerating price changes. Core inflation rose by 1.3% month-on-month translating into an 8.1% year-on-year figure in February, a level not seen since the autumn of 2001. The so-called sticky price inflation (which shows the prices of components of the consumer price index which are slow to change, and therefore are good predictors of medium-term developments in headline inflation) spiked to 8.1% year-on-year, an all-time high.

Headline and underlying inflation measures (% YoY)



Source: HCSO, NBH, ING

Double-digit inflation is in sight

Forecasting inflation for the upcoming months is highly challenging due to the Russia-Ukraine war and sanctions, which are impacting nearly every aspect of our lives. Risks have clearly moved further upside. First of all, the latest inflation print was higher in every aspect than we forecast. The rising price expectations of both households and corporates suggest that the repricing channel will remain quite strong. The forint valuation and the commodity price shocks are adding pressure as well, even despite the anti-inflationary shield measures. Our base case is that the government will let these expire, thus we will see a significant jump in inflation in May-June, probably above 10% year-on-year. We don't dare call a narrow forecast range for 2022, but we see 8.0-9.5% average inflation with further upside risks.

Central bank tightening continues

We expect the interest rate cycle to continue in the coming weeks (1-week deposit rate hikes) and months (raising 1-week deposit, the base rate and interest rate corridor). We expect the effective interest rate to rise to as much as 8.0% by the middle of this year. But this can change both upwards and downwards by the course of the Ukrainian war. We consider it less and less likely that inflation will return to the 3% target in 2023 with any realistic assumption of central bank tightening.

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